Industry Sector Analysis

Small Medium-Sized Enterprise Finance

U.S. Commercial Service
European Bank for Reconstruction and Development

INDUSTRY SECTOR ANALYSIS EBRD: SMALL MEDIUM-SIZED ENTERPRISE FINANCE

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I. INTRODUCING THE EBRD AND THE SMALL MEDIUM-SIZED FINANCE SECTOR

The EBRD provides lending partners with innovative products by responding to changing market conditions and client needs. The strong portfolio of micro and small enterprises (MSE) finance products helps the EBRD retain its position as one of the most successful MSE investors in the region. To maximize the leverage of its funding, the Bank also provides technical assistance which focuses in institution building and creating MSE lending expertise.

i. The Beginning

In April 1999, the EBRD and the European Commission launched the SME Finance Facility for micro, small and medium-sized enterprises operating in the EU Accession countries of central and Eastern Europe. This includes Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

The SME Finance Facility channels €846 million (€716 EBRD/€130 EU) to SMEs through loans to local banks, leasing companies and investments in private equity funds.

Loans and leases

Local banks and leasing companies focus on financing SMEs at the lower end of the size spectrum. The average loan/lease to a participating bank or leasing company is between €5 million and €15 million. The financing extended is normally for small enterprises with up to 100 employees (€30,000 to €100,000) and micro enterprises with less than 10 employees (up to € 30,000).

Banks and leasing companies are selected on the basis of their financial strength, branch network, knowledge of their clients and, most importantly, their commitment to engage in sustained SME lending.

The EU grant covers performance fees, which compensates the banks and leasing companies for start-up costs related to SME on lending. The grant also funds technical assistance aimed at:

- Recruiting and training of bank staff in small loan appraisal, supervision and administration
- Improving information systems
- Strengthening management capabilities such as marketing and SME client relationship management.

Equity
The equity funds range between €12 and €20 million, and maximum financing per investee is restricted to €1 million for a minority stake. Independent fund managers responsible for raising private capital manage the funds.

The EU contribution is structured to provide incentives to overcome the private sector's reticence about SME investment and to allow the Facility to attract competent fund managers.
The funds use the full range of equity and quasi-equity instruments and normally hold minority positions (10 - 49%). They do, however, secure rights enabling them to exercise corporate governance over the SME portfolio.

ii. Current Policy

Strategic priorities

- Provide sustainable finance to micro and small businesses
- Support institution building in commercial banks and non-bank micro finance institutions
- Encourage competition within the financial sector catering to micro and small enterprises
- Regional focus and emphasis on previously underserved markets

Products
Debt
The Bank grants senior and subordinated debt to commercial banks and non-bank micro finance institutions for on lending to MSEs. Amounts range from €20 to €200,000.

Equity
The Bank purchases ordinary or preference shares in microfinance banks and institutions, or existing commercial banks with a strategic focus on MSE finance.

Technical assistance
Technical assistance focuses on institution building and creating MSE lending expertise.
Such measures are important to ensure that EBRD's partners have the necessary capacity to enter the MSE finance market and to continue providing loans long after Bank assistance and investment have ceased.
This assistance, which is generously supported by EBRD's donor programs, focuses on:

- Staff training
- Streamlining of processes and procedures
- Implementation of best practice borrower analysis

- Integration of MSE lending into the partner banks' mainstream operations

Non-bank micro finance institutions
Non-bank micro finance institutions (MFIs) are a new and important delivery mechanism for the EBRD. The Bank provides leading regulated non-bank MFIs with senior debt for on-lending to micro borrowers. The Bank aims to support these financial intermediaries, particularly in their transformation to deposit-taking entities, and will consider future equity investments.

MSE focused equity funds
EBRD can invest in or alongside the increasing number of funds, which have been created to invest in financial institutions with a strategic commitment to the MSEs in the Bank's countries of operation.

New initiatives

Local currency financing
The Bank is exploring ways to meet the high demand for microfinance in local currency by using standby credit lines and issuing securities, the proceeds of which would be provided to partner institutions for on-lending to MSEs. The Bank has already engaged in local currency financing through programs in Hungary, Kazakhstan and Russia.

Micro leasing
It can be difficult for MSE entrepreneurs to obtain asset finance. Products available from MFIs are often short-maturity and those available from leasing companies are often too expensive. Leasing can provide a solution to the problem of lack of collateral faced by smaller businesses in the production sector. The EBRD is looking at how to downscale existing leasing operations to amounts that could benefit MSE clients. Another approach is to help financial intermediaries develop this product.

Risk sharing and securitization
The Bank is exploring risk-sharing products to share the risk of the MSE portfolios of its partners. It is also considering securitising loan portfolios.

Credit scoring
Credit scoring mechanisms help partners enhance the profitability and sustainability of their lending programs. New initiatives in this domain would build on the experience gained by EBRD in Central and Eastern Europe.

II. EBRD UTILIZING MICROFINACE WITH RUSSIA AND ROMANIA

i. Russia

The Russia Small Business Fund (RSBF), implemented by EBRD with the support of the G-7 countries, Switzerland and the EU, was established in 1994 to provide micro and small businesses with finance to fit their particular requirements, and to help strengthen the capacity of the Russian banking sector in order that it may effectively lend to micro and small businesses on a permanent basis.

The fund was established with a pledged contribution of US$150 million from EBRD and the same amount from donor countries. EBRD increased its financing to US$250 million in 2001. To date, the United States has provided US$42 million in grants and loan funds to the RSBF, followed by Japan with US$30 million; the EU has provided the RSBF with grant funds of €26.5 million, the UK, France and Germany granted US$15 million each, Canada provided US$8.1 million and Switzerland US$4.5 million. The fund encompasses both investment financing to Russian banks for on-lending to MSEs and technical assistance funding to develop these financial intermediaries and strengthen their lending capacity.

The banks currently participating in the Program are Absolut Bank, Chelindbank, FORUS Bank, KMB Bank, MDM Bank, NBD Bank, Probusinessbank, Transcapital Bank, UralSib Bank, Uraltransbank and URSA (formerly Sibakadembank and Uralvneshtorgbank). EBRD continues to actively seek new partner lending institutions among commercial banks as well as non-bank microfinance institutions and the credit co-operative sector.

The RSBF is being implemented in over 320 branches, 220 of which are fully functioning without technical assistance (TA). The program has reached 149 cities, with 12 new cities added during the last six months.

RESULTS TO DATE

As of end-March 2007, financing from the RSBF had helped leverage over 380,000 loans to MSEs in Russia. In value terms, over US$4.1 billion has been disbursed to MSEs, with an average loan size of US$10,919. The outstanding sub-loan portfolio stood at US$1.1 billion and portfolio quality remains strong with arrears over 30 days of only 1.66%.

RSBF	Results through March 2007
Total number of loans disbursed	379,638
Total volume of loans disbursed	4,145,196,991
Average loan amount	10,919
Outstanding portfolio – Number	79,575

Outstanding portfolio – Volume	1,051,983,530
Arrears % > 30 days	1.66%

ii. Romania

EBRD, EU and the Romanian government at work: Microfinance

About the facility

The challenge

Entrepreneurs in Romania, especially in remote and rural areas, have little access to finance other than from family members or sources beyond the financial sector that can charge very high interest rates. There are still not enough banks in Romania which are willing to lend to micro and small enterprises (MSEs) due to seemingly increased risks associated with the sector, while non-banks are largely limited by availability of funding.

The microfinance market in Romania

The microfinance market in Romania is estimated to be worth over €0.5 billion. Commercial banks meet 55 per cent of the microfinance market demand, only 15 per cent of the market is met by non-bank micro finance institutions (NBMFIs) and at least 30 per cent of the market remains uncovered overall. The proportion of uncovered market in rural areas as well as lending to start-up MSEs is likely to be much higher. In general, for the proportion of the micro, small and medium-sized enterprises (MSMEs) per inhabitant, Romania is estimated to have about 13.6 active MSMEs per 1,000 inhabitants, which is less than half of that of neighboring Bulgaria (27.6 MSMEs per 1,000 inhabitants) and even less than when compared to Czech Republic, Hungary Slovakia and Slovenia (42.7 MSMEs per 1,000 inhabitants).

The project and its donors

The Romania Micro Credit Facility (RMCF) provides loans – in Euro or local currency, lei – to local banks and non-bank micro finance institutions to lend to the smallest enterprises, sole entrepreneurs and farmers. The new facility is financed with:

- €40 million from the EBRD
- €13.6 million from the EC Delegation office in Romania, through the EU Phare Program
- €4.42 from the Romanian government via the Romanian Ministry of Development, Public Works and Housing.

Part of the EU Phare and the Romanian government financing is €2.5 million of technical assistance funds to support institution building of the partner lending with the aim to increase lending to MSEs including among other development of new financing products for MSEs, training of staff in providing financing to MSEs and MSE products marketing. To encourage partner lending institutions to finance more start-up MSEs (those less than 12 months old) €3 million of the EU and Romanian government finance has been earmarked for the risk-sharing facility to support lending to start-up micro businesses.

How to become a partner lending institution

Existing partner lending institutions
Opportunity Micro-Credit Romania (OMRO), a micro finance institution in central Romania, was the first to receive funding under the Romania Micro Credit Facility. A RON 9.85 million (€2.8 million) loan was signed in December 2006 to assist OMRO to build on its existing portfolio of micro-business clients.
Banca Transilvania. A €15 million loan was signed in August 2007 to increase Banca Transilvania's lending to the smallest of micro enterprises and start-ups.
Express Finance?? The newest partner to participate in the program offers business loans to micro and small entrepreneurs as well as housing and energy efficiency loans. The €2.25 million loan signed in September 2007 will enable Expres Finance to on-lend finance to local enterprises across the country wishing to start up or expand their businesses.

How to become a partner lending institution
EBRD is seeking to engage as many partner lending institutions as possible. To become a partner of the RMCF, an applicant bank or a non-bank microfinance institution must be financially stable and have a strategy focused on serving micro and small enterprises. When selecting potential partner lending institutions, the EBRD project team carries out a detailed analysis of the financial status and the loan portfolio. The applicant should submit its audited financial statements of the last three years prepared by EBRD accepted audit companies and preferably in accordance with the International Financial Reporting Standards.

What we offer partner lending institutions
Loan funding is provided to partner lending institutions on commercial terms in the form of senior loans.
The RMCF considers institution building of its partner lending institutions to be one of its crucial tasks. The partner lending institutions will be offered a technical assistance package to assist in introducing or increasing lending to small micro enterprises, start-ups MSEs and/or MSE lending expansion in the identified priority areas in accordance with their respective business plan. The package will be completely tailor-made in order to reflect the partner institution's specific needs in this area and can range from new MSE product development, development of new or enhancement of MSE lending technologies to training of MSE loan officers, institutional strengthening.

iii. United States of America

The US/EBRD SME Financing Facility was established in July 2000 in the amount of US$150 million (US$50 million from the US and US$100 million from EBRD) to promote private sector growth and economic development in South East Europe (SEE) and Early and Intermediate Transition (EIT) Countries.[1] To date the United States has contributed a total of US$40.2 million, which together with EBRD's on-lending funds of US$227 million has financed 10 microfinance banks, 8 local bank programs and 2 NBMFI program in 15 countries.

The Facility provides 1) financing to local banks for on-lending to SMEs; 2) technical assistance and training to financial intermediaries to strengthen their lending capacity; and 3) funding for policy dialogue efforts which focus on reducing the impediments to SME finance. The US also provides first loss coverage in several countries, which generates greater EBRD leverage in relatively high-risk markets.

Initially the Fund operated only in South East Europe. However, beginning mid-2002, the Facility was expanded to cover countries of the Former Soviet Union, beginning with Georgia, Kazakhstan, the Kyrgyz Republic and Ukraine. Tajikistan was added in 2003, and Belarus and Armenia were included in April and September 2005 respectively.

RESULTS TO DATE

As of end-March 2007, financing from the Facility had helped leverage 1,539,792 loans to SME clients across 15 countries. In value terms, over US $9.8 billion has now been disbursed to SMEs, with an average loan size of US$6,401. The outstanding sub-loan portfolio stands at US$3.8 billion and portfolio quality remains strong with arrears over 30 days of only 2.0%.

Partner Banks	**Results through March 2007**
Total number of loans disbursed	**1,539,792**
Total volume of loans disbursed	**$ 9,857,245,442**
Average loan amount	**$ 6,401**
Outstanding portfolio – Number	**581,490**
Outstanding portfolio – Volume	**$ 3,823,974,559**
Arrears % > 30 days	**2.02%**

III. EBRD AND SMALL MEDIUM-SIZED FINANCE CASE STUDIES

i. Montenegro

Expanding the family business in Montenegro

Renowned as the centre of traditional Montenegrin cuisine, Cetinje is famous for its smoked ham (known locally as “prsuto”) and its cheeses. Visitors come from far and wide to try the local produce and to appreciate the attractions of this historical city, which lies at the foot of Mount Lovc´en, the Black Mountain, from which Montenegro gets its name. As the old capital of Montenegro, the city grew rapidly but the Balkan wars and the First World War halted its expansion. Today, it has a population of 15,000 and relies on tourism to generate much of its income.

Cetinje is on the verge of a revival but many of the city’s entrepreneurs struggle to get the financing that they need to build their businesses. One such entrepreneur is Nikola Martinovic´. Following in his father’s footsteps, Nikola had taken over the running of the family business but needed finance to expand his company’s production of prsuto and quality cheeses. So he turned to Alter Modus for assistance.

Alter Modus is a specialist microfinance institution that was originally set up to help refugees and internally displaced people. Back in the 1990s, these represented up to 20 per cent of Montenegro’s population. Nowadays they account for just over 4 per cent. From its humble beginnings, Alter Modus has quickly grown into a savior for businesses in desperate need of financing. Operating as a non-governmental organization, Alter Modus provides small loans (averaging €1,600) to people from all walks of life. In 2004 it became the first NGO to receive a loan from the EBRD. A sum of €1 million was provided under the US/EBRD SME Finance Facility.

The aim of Alter Modus is to help people with potential that have good business proposals. When Nikola Martinovic´ sought assistance, it provided him with a loan of €1,500. Nikola used this to renovate his premises for drying ham and to purchase more meat. Another loan, of €3,000, was used to buy a 500-litre container for processing milk. This allowed Nikola to enter into an arrangement with a local dairy, from which he buys his milk on a daily basis.

A third loan, of €2,000, was used to further improve his facilities in response to the growing demand for his produce. Nikola says that the loans acted as a lifeline for him, allowing him to more than quadruple his cheese production within a very short period of time – he currently produces over 50 kilos of cheese a day. The loans enabled him to expand his business much faster than if he had relied on using profits from his normal business operations. His story is typical of many who have benefited from financing from Alter Modus, whose credit portfolio now stands at over €5 million.

ii. Mongolia

Small finance brings big rewards

Mongolia, whose 2.5 million people inhabit a vast, landlocked land between Russia and China, urgently needs microfinance services to help its economy grow and alleviate poverty.

In keeping with its business plan to move further south and east, the EBRD accepted Mongolia as its newest country of operations in October 2006 and promptly signed its first commercial deal there – a €3.8 million loan to XacBank, a micro credit institution.

XacBank has more than 50,000 clients and makes 85 per cent of its loans to small businesses, many of them microfinance customers in rural areas. The bank is unconventional in accepting all kinds of collateral – including the “gers” or tents in which many Mongolian nomads still live – as pledges for loans.

Sersenjav Elbegzaya was an early beneficiary of XacBank financing. In 2003 she moved to Mongolia’s capital Ulaanbaatar. Recently widowed, Sersenjav decided to set up a business to help her family survive and to see her daughter through university. XacBank gave a €152 loan against her ger and home appliances. Two other loans followed as her business selling scarves and bags in the city’s open-air market expanded – each time double the previous amount, each loan increasing her profit. Her business continues strengthen.

“We started with a social mission, to provide credit to micro and small businesses,” explains XacBank’s President, Magvan Bold. “And we have become their most trusted partner.”

XacBank started in 1998 as a United Nations Development Program “MicroStart” project, with an initial €0.8 million to lend to poor people with business ideas. XacBank’s capital has grown to €7.6 million with total assets of €58 million in 2006. It attributes this to its focus on the poor, who have proved to be reliable payers. Less than 1 per cent of XacBank’s loans are overdue for 30 days or more.

The EBRD’s €3.8 million loan will particularly benefit rural customers. A further €0.8 million that the Bank is providing in support of trade finance will cushion clients financing imports and exports. EBRD financing is expected to strengthen Mongolia’s financial sector – which will, in turn, benefit consumers, generate employment and improve living standards.

Although the EBRD only accepted Mongolia as a country of operations in October 2006, the Bank had been working with the country for some years through donor-funded projects. The Mongolian Cooperation Fund was set up in March 2001 with more than €10 million of donor funding.

iii. Tajikistan

Helping artisans in Tajikistan

Tajikistan, a country rich in culture and tradition, is renowned for its artisans and craftsmen. The fabrication of national head covers – tyubeteykas and embroidered wedding caps - is one of the old crafts, passed down from generation to generation. A Tajik or Uzbek wedding is impossible to think of without gold embroidered Tyubeteykas, Khalats and Chalmas.

Maston Kholmuradova, a resident of Tursunzade, is the offspring of a dynasty of craftsmen that specialize in gold embroidery. She sold her first self embroidered tyubeteykas 20 years ago. Since then her head covers, national wedding gowns and table and bed overlays are in high demand among the population of Tursunzade and in other regions of Tajikistan.

Alongside her three daughters, Maston Kholmuradova also trades other crafts that she buys in the Uzbek towns of Andijon, Kokand, Ferghona, Namangon and Marghilon.

As demand for head covers and other wedding paraphernalia grew Maston needed additional funds to get the necessary amount of raw materials and trade a wider variety of goods for such occasions. She received a USD 1,000 loan in the Tursunzade branch of TajPrombank.

"I learned from my friends, traders on the bazaar, who themselves have received a loan, that the bank is giving such loans. Quiet frankly, I was astonished, when in the course of only two days I got the loan without bureaucratic hassle. In fact, I still cannot believe it! And yes repaying the loan is not really the issue since my business will grow faster now."

iv. Belgrade

Financing for farmers in Belgrade

Mr. Veroljub Tosakovic carries out the family tradition of agriculture in a large farm situated 30 km south of Belgrade - a region well known for its farming. Veroljub’s farm has lots of diary cattle producing 350 liters of milk per day.

Mr. Tosakovic is currently expanding all of his activities and has purchased new machines to improve corn production and field work. Thanks to hard work, experience and investments in modernization he also offers services to third parties.

He has one loan outstanding in amount of €3,000 with a repayment period of 18 months and approval of a further loan, in the amount of €8,000 maturing in 36 months, is imminent. This will be his third loan with the bank and he is also a guarantor for a group of four agricultural producers from the same village.

IV. HOW U.S. COMPANIES INTERESTED IN WORKING WITH THE EBRD IN THE SMALL MEDIUM-SIZED ENTERPRISE FINANCE SECTOR

As one can see from the report the U.S. already is actively involved with their on going US/EBRD SME Financing Facility. The EBRD works with U.S. firms as Borrowers/Investors for Private Sector Sponsored Projects. U.S. firms sponsoring projects must be fully cognizant of the EBRD's mandate and criteria for projects and must have a well-prepared business plan that addresses the developmental mandate of the bank and financial risk. Another way the EBRD is involved with the U.S. is that U.S. firms act as bidders on tenders as contractors for equipment, works and services on Bank financed public sector projects. Lastly the EBRD works with the U.S. through soliciting their companies for consulting and technical services. If you are interested in becoming involved in this project or other projects you should visit http://www.buyusa.gov/ebrd/.

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